GROUP 1 AUTOMOTIVE INC
Form 10-Q
August 03, 2016

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

þ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2016
or
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to
Commission File Number: 1-13461

Group 1 Automotive, Inc.

(Exact name of registrant as specified in its charter)

Delaware	76-0506313
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

800 Gessner, Suite 500
Houston, Texas 77024
(Address of principal executive offices) (Zip code)
(713) 647-5700
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No ¨
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this Chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes þ No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer þ ¨ Accelerated filer

Non-accelerated filer ¨ (Do not check if a smaller reporting company) ¨ Smaller reporting company
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes ¨ No þ
As of July 28, 2016, the registrant had 21,354,073 shares of common stock, par value $0.01, outstanding.

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PART I. FINANCIAL INFORMATION
Item 1. Financial Statements
GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

	June 30, 2016	December 31, 2015
	(Unaudited, in thousands, except per share amounts)	
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$24,965	$13,037
Contracts-in-transit and vehicle receivables, net	212,304	252,438
Accounts and notes receivable, net	151,655	157,768
Inventories, net	1,784,114	1,737,751
Prepaid expenses and other current assets	28,919	27,376
Total current assets	2,201,957	2,188,370
PROPERTY AND EQUIPMENT, net	1,081,232	1,033,981
GOODWILL	881,981	854,915
INTANGIBLE FRANCHISE RIGHTS	322,974	307,588
OTHER ASSETS	12,656	11,862
Total assets	$4,500,800	$4,396,716
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Floorplan notes payable - credit facility and other	$1,239,220	$1,265,719
Offset account related to floorplan notes payable - credit facility	(35,461)	(110,759)
Floorplan notes payable - manufacturer affiliates	397,295	389,071
Offset account related to floorplan notes payable - manufacturer affiliates	(27,500)	(25,500)
Current maturities of long-term debt and short-term financing	42,993	54,991
Accounts payable	313,219	280,423
Accrued expenses	182,108	185,323
Total current liabilities	2,111,874	2,039,268
LONG-TERM DEBT, net of current maturities	1,250,940	1,199,534
DEFERRED INCOME TAXES	140,462	136,644
LIABILITIES FROM INTEREST RATE RISK MANAGEMENT ACTIVITIES	49,438	31,153
OTHER LIABILITIES	80,534	71,865
STOCKHOLDERS' EQUITY:		
Preferred stock, $0.01 par value, 1,000 shares authorized; none issued or outstanding	—	—
Common stock, $0.01 par value, 50,000 shares authorized; 25,702 and 25,706 issued, respectively	257	257
Additional paid-in capital	284,887	291,092
Retained earnings	996,944	926,169
Accumulated other comprehensive loss	(154,404)	(137,984)
Treasury stock, at cost; 4,095 and 2,291 shares, respectively	(260,132)	(161,282)
Total stockholders' equity	867,552	918,252
Total liabilities and stockholders' equity	$4,500,800	$4,396,716

The accompanying notes are an integral part of these consolidated financial statements.

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GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
	(Unaudited, in thousands, except per share amounts)			
REVENUES:				
New vehicle retail sales	$1,540,759	$1,534,262	$2,950,609	$2,866,986
Used vehicle retail sales	715,778	682,294	1,403,949	1,305,487
Used vehicle wholesale sales	96,279	101,512	197,871	201,704
Parts and service sales	322,073	303,193	630,665	585,382
Finance, insurance and other, net	107,560	105,219	207,710	199,775
Total revenues	2,782,449	2,726,480	5,390,804	5,159,334
COST OF SALES:				
New vehicle retail sales	1,459,611	1,458,132	2,797,734	2,721,125
Used vehicle retail sales	667,513	636,235	1,306,484	1,213,307
Used vehicle wholesale sales	96,331	102,445	196,474	199,958
Parts and service sales	148,875	138,095	290,891	269,487
Total cost of sales	2,372,330	2,334,907	4,591,583	4,403,877
GROSS PROFIT	410,119	391,573	799,221	755,457
SELLING, GENERAL AND ADMINISTRATIVE EXPENSES	299,022	280,568	592,687	552,037
DEPRECIATION AND AMORTIZATION EXPENSE	12,713	11,946	25,177	23,630
ASSET IMPAIRMENTS	1,024	1,039	1,956	1,039
INCOME FROM OPERATIONS	97,360	98,020	179,401	178,751
OTHER EXPENSE:				
Floorplan interest expense	(11,593)	(10,015)	(22,603)	(19,362)
Other interest expense, net	(16,705)	(14,228)	(33,634)	(28,139)
INCOME BEFORE INCOME TAXES	69,062	73,777	123,164	131,250
PROVISION FOR INCOME TAXES	(22,482)	(27,467)	(42,293)	(49,126)
NET INCOME	$46,580	$46,310	$80,871	$82,124
BASIC EARNINGS PER SHARE	$2.12	$1.91	$3.57	$3.38
Weighted average common shares outstanding	21,057	23,312	21,753	23,377
DILUTED EARNINGS PER SHARE	$2.12	$1.91	$3.57	$3.38
Weighted average common shares outstanding	21,070	23,315	21,762	23,380
CASH DIVIDENDS PER COMMON SHARE	$0.23	$0.20	$0.45	$0.40

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GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
	(Unaudited, in thousands)			
NET INCOME	$46,580	$46,310	$80,871	$82,124
Other comprehensive income (loss), net of taxes:				
Foreign currency translation adjustment	(6,068)	9,999	(3,913)	(20,595)
Net unrealized gain (loss) on interest rate risk management activities:				
Unrealized gain (loss) arising during the period, net of tax benefit (provision) of $3,373, ($1,082), $10,058 and $2,825 respectively	(5,621)	1,804	(16,763)	(4,709)
Reclassification adjustment for gain (loss) included in interest expense, net of tax provision of $1,285, $1,188, $2,553 and $2,368 respectively	2,141	1,980	4,256	3,947
Net unrealized gain (loss) on interest rate risk management activities, net of tax	(3,480)	3,784	(12,507)	(762)
OTHER COMPREHENSIVE INCOME (LOSS), NET OF TAXES	(9,548)	13,783	(16,420)	(21,357)
COMPREHENSIVE INCOME	$37,032	$60,093	$64,451	$60,767

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GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

	Common Stock		Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Treasury Stock	Total
	Shares	Amount					
	(Unaudited, in thousands)						
BALANCE, December 31, 2015	25,706	$ 257	$291,092	$926,169	$ (137,984)	$(161,282)	$918,252
Net income	—	—	—	80,871	—	—	80,871
Other comprehensive loss, net	—	—	—	—	(16,420)	—	(16,420)
Purchases of treasury stock	—	—	—	—	—	(115,246)	(115,246)
Net issuance of treasury shares to employee stock compensation plans	(4)	—	(16,261)	—	—	16,396	135
Stock-based compensation, including tax effect of $85	—	—	10,056	—	—	—	10,056
Cash dividends, net of estimated forfeitures relative to participating securities	—	—	—	(10,096)	—	—	(10,096)
BALANCE, June 30, 2016	25,702	$ 257	$284,887	$996,944	$ (154,404)	$(260,132)	$867,552

The accompanying notes are an integral part of these consolidated financial statements.

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GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Six Months Ended June 30,	
	2016	2015
	(Unaudited, in thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$80,871	$82,124
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	25,177	23,630
Deferred income taxes	7,984	8,100
Asset impairments	1,956	1,039
Stock-based compensation	10,169	9,453
Amortization of debt discount and issue costs	2,085	1,812
Gain on disposition of assets	(617)	(1,507)
Tax effect from stock-based compensation	85	(1,439)
Other	499	2,278
Changes in operating assets and liabilities, net of effects of acquisitions and dispositions:		
Accounts payable and accrued expenses	15,473	31,197
Accounts and notes receivable	8,564	1,399
Inventories	(22,080)	(88,738)
Contracts-in-transit and vehicle receivables	44,667	3,243
Prepaid expenses and other assets	15,573	3,427
Floorplan notes payable - manufacturer affiliates	(17,268)	4,876
Deferred revenues	(271)	(319)
Net cash provided by operating activities	172,867	80,575
CASH FLOWS FROM INVESTING ACTIVITIES:		
Cash paid in acquisitions, net of cash received	(54,739)	(130,783)
Proceeds from disposition of franchises, property and equipment	13,985	7,339
Purchases of property and equipment, including real estate	(70,272)	(48,486)
Other	3,156	6,294
Net cash used in investing activities	(107,870)	(165,636)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Borrowings on credit facility - floorplan line and other	3,373,126	3,550,526
Repayments on credit facility - floorplan line and other	(3,325,917)	(3,466,772)
Borrowings on credit facility - acquisition line	150,020	346,050
Repayment on credit facility - acquisition line	(140,020)	(324,222)
Borrowings on other debt	19,653	25,744
Principal payments on other debt	(22,248)	(26,942)
Borrowings on debt related to real estate, net of debt issue costs	30,754	22,430
Principal payments on debt related to real estate	(12,215)	(14,359)
Employee stock purchase plan purchases, net of employee tax withholdings	136	(1,113)
Repurchases of common stock, amounts based on settlement date	(115,246)	(33,121)
Tax effect from stock-based compensation	(85)	1,439
Dividends paid	(10,124)	(9,737)
Other	(3,159)	—
Net cash provided by (used in) financing activities	(55,325)	69,923
EFFECT OF EXCHANGE RATE CHANGES ON CASH	2,256	(1,612)

NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	11,928	(16,750)
CASH AND CASH EQUIVALENTS, beginning of period	13,037	40,975
CASH AND CASH EQUIVALENTS, end of period	$24,965	$ 24,225
SUPPLEMENTAL CASH FLOW INFORMATION:		
Purchases of property and equipment, including real estate, accrued in accounts payable	$21,241	$ 5,731

The accompanying notes are an integral part of these consolidated financial statements.
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GROUP 1 AUTOMOTIVE, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. INTERIM FINANCIAL INFORMATION

Business and Organization

Group 1 Automotive, Inc., a Delaware corporation, is a leading operator in the automotive retailing industry with business activities in 14 states in the United States of America ("U.S."), 19 towns in the United Kingdom ("U.K.") and four states in Brazil. Group 1 Automotive, Inc. and its subsidiaries are collectively referred to as the "Company" in these Notes to Consolidated Financial Statements.

The Company, through its regions, sells new and used cars and light trucks; arranges related vehicle financing; sells service and insurance contracts; provides automotive maintenance and repair services; and sells vehicle parts. As of June 30, 2016, the Company’s U.S. retail network consisted of the following two regions (with the number of dealerships they comprised): (a) the East (37 dealerships in Alabama, Florida, Georgia, Louisiana, Maryland, Massachusetts, Mississippi, New Hampshire, New Jersey, and South Carolina), and (b) the West (77 dealerships in California, Kansas, Louisiana, Oklahoma, and Texas). The U.S. regional vice presidents report directly to the Company's Chief Executive Officer and are responsible for the overall performance of their regions, as well as for overseeing the market directors and dealership general managers that report to them. In addition, as of June 30, 2016, the Company had two international regions: (a) the U.K. region, which consisted of 29 dealerships in the U.K. and (b) the Brazil region, which consisted of 18 dealerships in Brazil. The operations of the Company's international regions are structured similarly to the U.S. regions, each with a regional vice president reporting directly to the Company's Chief Executive Officer.

The Company's operating results are generally subject to seasonal variations, as well as changes in the economic environment. This seasonality is generally attributable to consumer buying trends and the timing of manufacturer new vehicle model introductions. In addition, in some markets within the U.S., vehicle purchases decline during the winter months due to inclement weather. As a result, U.S. revenues and operating income are typically lower in the first and fourth quarters and higher in the second and third quarters. For the U.K., the first and third calendar quarters tend to be stronger, driven by plate change months of March and September. For Brazil, the Company expects higher volumes in the third and fourth calendar quarters. The first quarter is generally the weakest, driven by heavy consumer vacations and activities associated with Carnival. Other factors unrelated to seasonality, such as changes in economic condition, manufacturer incentive programs, or shifts in governmental taxes or regulations may exaggerate seasonal or cause counter-seasonal fluctuations in the Company's revenues and operating income.

Basis of Presentation

The accompanying unaudited condensed Consolidated Financial Statements have been prepared in accordance with accounting principles generally accepted in the U.S. ("U.S. GAAP") for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. In the opinion of management, all adjustments of a normal and recurring nature considered necessary for a fair presentation have been included in the accompanying unaudited condensed Consolidated Financial Statements. Due to seasonality and other factors, the results of operations for the interim period are not necessarily indicative of the results that will be realized for any other interim period or for the entire fiscal year. For further information, refer to the Consolidated Financial Statements and footnotes thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2015 (“2015 Form 10-K”).

All business acquisitions completed during the periods presented have been accounted for using the purchase method of accounting, and their results of operations are included from the effective dates of the closings of the acquisitions. The allocations of purchase price to the assets acquired and liabilities assumed are assigned and recorded based on estimates of fair value and are subject to change within the purchase price allocation period (generally one year from the respective acquisition date). All intercompany balances and transactions have been eliminated in consolidation.

Business Segment Information

The Company, through its regions, conducts business in the automotive retailing industry including selling new and used cars and light trucks, arranging related vehicle financing, selling service and insurance contracts, providing automotive maintenance and repair services and selling vehicle parts. The Company has three reportable segments: the U.S., which includes the activities of the Company's corporate office, the U.K. and Brazil. The reportable segments are the business activities of the Company for which discrete financial information is available and for which operating results are regularly reviewed by its chief operating decision maker to allocate resources and assess performance. The Company's chief operating decision maker is its Chief Executive Officer. See Note 14, "Segment Information," for additional details regarding the Company's reportable segments.

Variable Interest Entity

In 2013, the Company entered into arrangements to provide a related-party entity, which owns and operates retail automotive dealerships, a fixed-interest-rate working capital loan and various administrative services for a variable fee, both of which constitute variable interests in the entity. The Company's exposure to loss as a result of its involvement in the entity includes the balance outstanding under the loan arrangement. The Company holds an 8% equity ownership interest in the entity. The Company has determined that the entity meets the criteria of a variable interest entity ("VIE"). The terms of the loan and services agreements provide the Company with the right to control the activities of the VIE that most significantly impact the VIE's economic performance, the obligation to absorb potentially significant losses of the VIE and the right to receive potentially significant benefits from the VIE. Accordingly, the Company qualified as the VIE's primary beneficiary and consolidated the assets and liabilities of the VIE as of June 30, 2016 and December 31, 2015, as well as the results of operations of the VIE beginning on the effective date of the variable interests arrangements to June 30, 2016. The floorplan notes payable liability of the VIE is securitized by the new and used vehicle inventory of the VIE. The carrying amounts and classification of assets (which can only be used to settle the liabilities of the VIE) and liabilities (for which creditors do not have recourse to the general credit of the Company) that are included in the Company's consolidated statements of financial position for the consolidated VIE as of June 30, 2016 and December 31, 2015, are as follows (in thousands):

	June 30, 2016	December 31, 2015
Current assets	$12,721	$ 12,849
Non-current assets	13,489	11,022
Total assets	$26,210	$ 23,871
Current liabilities	$9,783	$ 8,257
Non-current liabilities	20,935	17,064
Total liabilities	$30,718	$ 25,321

Recently Adopted Accounting Pronouncements

In November 2015, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2015-17, Income Taxes (Topic 740) Balance Sheet Classification of Deferred Taxes. This update requires an entity to classify deferred tax liabilities and assets as non-current within a classified statement of financial position. ASU 2015-17 is effective for annual reporting periods, and interim periods therein, beginning after December 15, 2016. This update may be applied either prospectively to all deferred tax liabilities and assets or retrospectively to all periods presented. Early application is permitted as of the beginning of the interim or annual reporting period. The Company elected to early adopt ASU 2015-17 during the first quarter of fiscal 2016, with retrospective application. Accordingly, deferred tax assets in the amount of $14.1 million, which were previously classified as current assets at December 31, 2015, were reclassified to non-current deferred income tax liabilities on the Company's Consolidated Balance Sheets to conform to current year presentation.

In April 2015, the FASB issued ASU 2015-03, Interest-Imputation of Interest (Subtopic 835-30) Simplifying the Presentation of Debt Issuance Costs. The amendments in the accounting standard require debt issuance costs to be presented on the balance sheet as a direct reduction from the carrying amount of the related debt liability. The amendments in this ASU were to be applied retrospectively and were effective for interim and annual periods beginning after December 15, 2015. The Company adopted ASU 2015-03 during the first quarter of fiscal 2016, with retrospective application. Accordingly, debt issuance costs in the amounts of $0.5 million and $3.6 million, which were previously classified as current and long-term assets, respectively, at December 31, 2015, were reclassified as a direct reduction from the carrying amount of the related debt liability on the Company's Consolidated Balance Sheets to conform to current year presentation.

In September 2015, the FASB issued ASU 2015-16, Business Combinations (Topic 805) Simplifying the Accounting for Measurement-Period Adjustments. The amendments in the accounting standard eliminate the requirement for an acquirer in a business combination to account for measurement-period adjustments retrospectively. The amendments also require that the acquirer must recognize adjustments to provisional amounts that are identified during the measurement period in the reporting period in which the adjustment amount is determined, including the effect on earnings of any amounts they would have recorded in previous periods if the accounting had been completed at the acquisition date. The amendments in this ASU were to be applied prospectively to adjustments to provisional amounts that occur after the effective date and were effective for interim and annual periods beginning after December 15, 2015. The Company adopted ASU 2015-16 during the first quarter of fiscal 2016. The adoption of this amendment did not materially impact the Company's financial statements.

Recent Accounting Pronouncements

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606) that amends the accounting guidance on revenue recognition. The amendments in this ASU are intended to provide a framework for addressing revenue issues, improve comparability of revenue recognition practices, and improve disclosure requirements. The amendments in this accounting standard update are effective for interim and annual reporting periods beginning after December 15, 2017. The Company is currently evaluating the method of adoption and the impact that the adoption of the provisions